DOW THEORY LETTERS INC.

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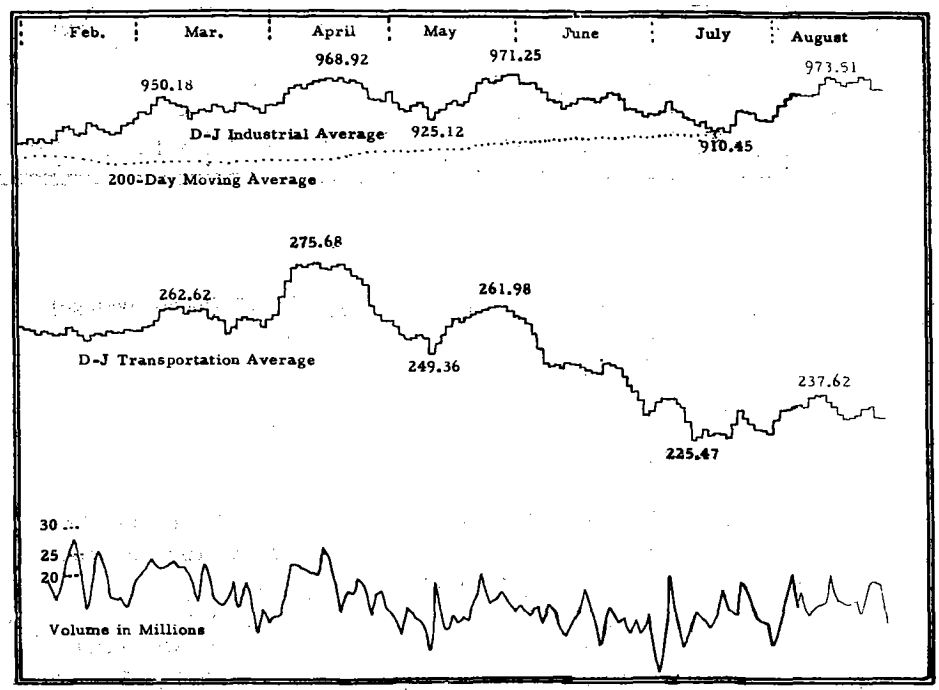
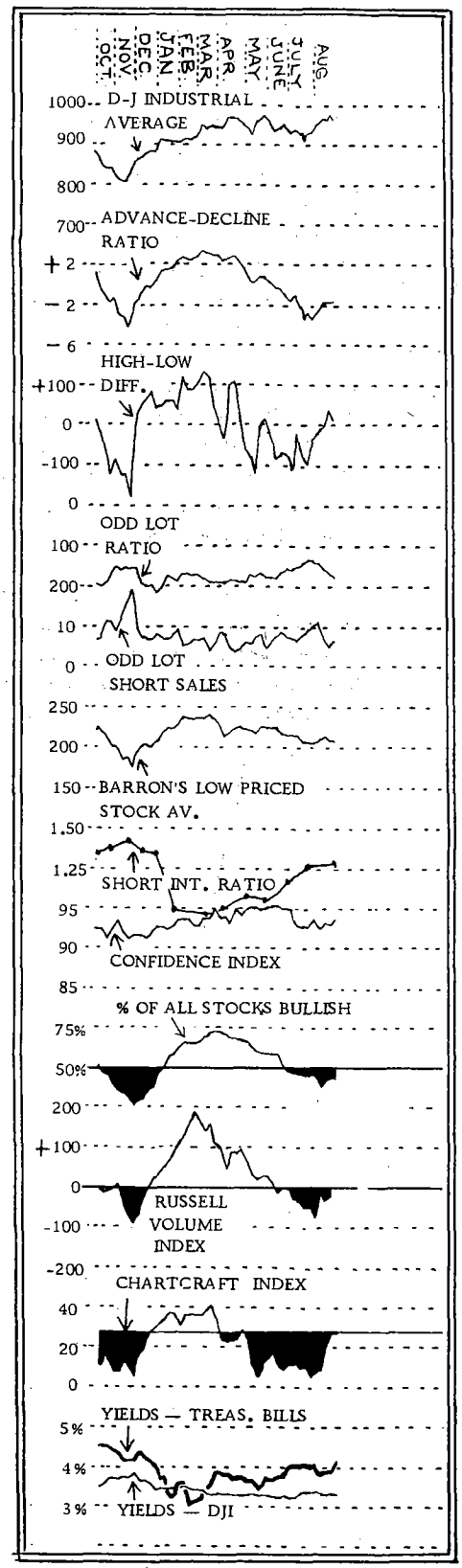
THE MARKET: We are currently witnessing a most extraordinary series of events in the stock market. Part of the picture is discussed in the section of this Letter entitled "Long Range." But I want immediately to turn to the chart on page 2, which follows the daily path of (1) the D-J Industrials, (2) the Primary Trend Index (PTI), which is made up of eight critical indices, and (3) the advance-decline ratio, which shows the direction of the majority of stocks on the NYSE.

As to the Dow itself, note that I have lettered all the rally and decline points since March 6 in order. Point A on March 6 was 950.18 (closing basis). Point B (March 13) was 928.66, C was 968.92 (April 18), D was 925.12 (May 9), E was 971.25 (May 26), F was 910.45 (July 20), and G was 973.51 (August 14). On August 21 the Dow again closed at exactly 973.51, an incredible event, since this was the identical level of the August 14 peak. For numerologists, it is of interest that 973.51 is made up of the perfect numerical series 1, 3, 5, 7, 9.

What we see on the Dow is a seven-point reversal pattern, starting on March 6, with each high above the preceding high and each low below the preceding low. I have seen five-point reversals in the Dow before but never a seven-point reversal. Such a series of reversals is classically known as a broadening top, and these multi-reversal formations are almost always associated with distribution. They are indicative of a market being whipped back and forth by alternating waves of optimism and pessimism. At any rate, the current structure is certainly both rare and fascinating.

Note that against the three ascending Dow peaks C, E, and G, we have the three descending PTI peaks, C, E, and G. This is as clear a series of non-confirmations

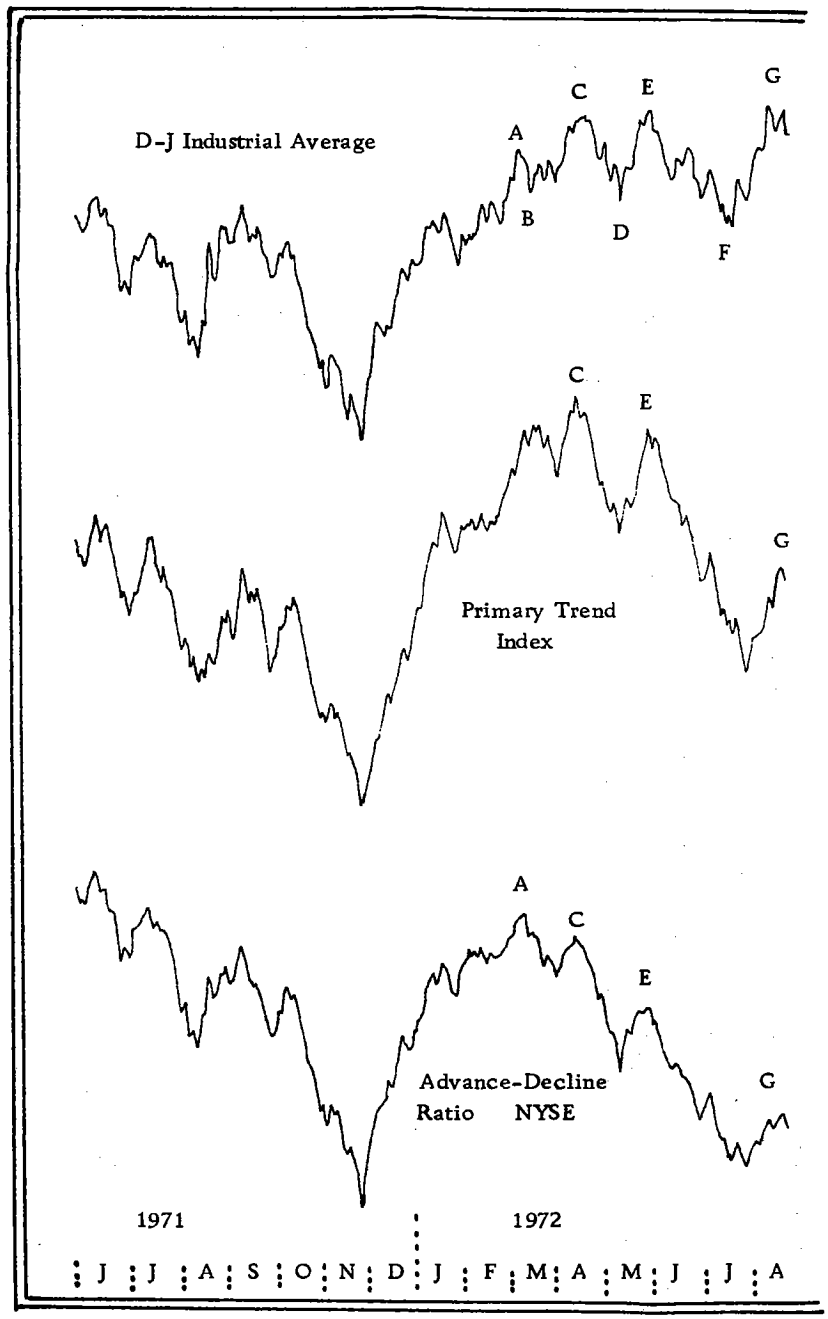




as the PTI is capable of giving. It can hardly be construed as bullish.

Even more glaring is the series of four diverging peaks as seen at the points A, C, E and G which appear in comparing the Dow with the A-D ratio. I do not ever remember seeing such a series of outstanding divergences between breadth (A-D ratio) and price (the Dow). In the past, such divergences have been decidedly bearish and few markets have withstood them for long. For what this chart is showing is a basic "out-of-gear" or imbalanced structure with the Dow Average pushing higher in its exotic broadening top structure while the other technical gauges (i. e., the PTI and the A-D ratio) form a series of descending peaks. If the whole market including all the Averages is topping out here, it should be no surprise to anyone who studies the page 2 chart!

I have written a good deal about daily new highs as an indicator of general upside market momentum during rallies. In view of this, the following tabulations are of note:



DATE	DOW CLOSING	NEW HIGHS (5-day average)
March 6, 1972	950.18	139
April 18, 1972	968.92	140
May 26, 1972	971.25	74
August 14, 1972	973.51	64
August 21, 1972	973.51	55

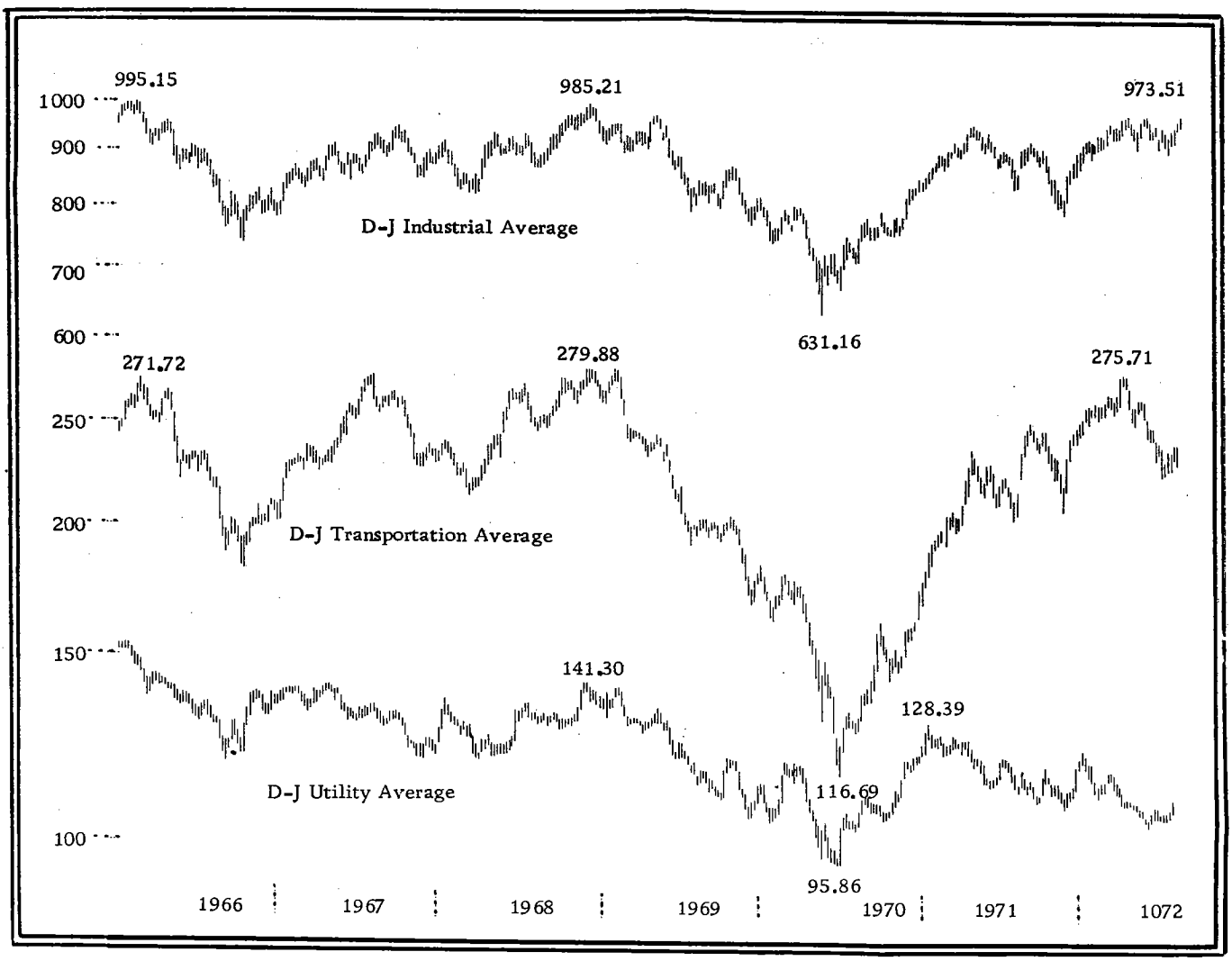
What the above figures indicate is that the market now acts like a group of mountain climbers. Their leader, the Dow Industrial Average, keeps pushing up but one by one the members of the group drop back exhausted. Shortly, the leader is going to find himself alone and unsupported. He cannot make the ascent to the top solely on his own.

When the market is subject to as much divergence and strain as it now is, we can almost feel the tension. On August 24 the tension came out in the open as the Dow suddenly dropped 11.97 points, thereby backing away from its 973.51 peak.

As if they were "plugged in" to some great crystal ball in the sky, all the market analysts have suddenly come out with the prediction that the Dow will now sink back to "the mid-940's, " consolidate, then push out in its long-heralded voyage to 1000 and over. Maybe I've been looking at the charts too long, and maybe I've seen too many "market scripts" go wrong. But I feel that there is much more technical deterioration here than most advisory services are willing to admit. All you have to do is check some of their theoretical portfolios. Very few of them have done well; most of them have been a study in perspiration and trading dollars for many small losses and a few compensatory gains.

LONG RANGE: I have found (and I exchange complimentary subscriptions with about 25 other outfits) that the rarest thing in the world is a good, long-term chart of the Averages. At any rate, here is my own long-range (weekly high-low) chart of the three Dow Jones common stock Averages going back to January, 1966. Note that the chart is drawn to semi-logarithmic proportions, which means that all movements can be correctly compared (since they are seen in terms of percentages). A rally from 100 to 200 on Transports will show in the exact same vertical distance as a rally from 500 to 1000 in Industrials. By the same token, trendlines drawn on semi-log scale have great validity since they measure rate of advance or decline.

This chart last appeared in Letter 526, and I feel that this is a good time to bring it up to date, along with my new conclusions. The first thing which is apparent is that the Dow is now back in its top area of the 1966 and 1968 highs. This could represent the final formation of the greatest "triple top" in Wall Street history, but we must remember that tops are only tops in retrospect. In other words, we know we have seen a top only after the market has turned down and we look back and say, "Oh yeah, I remember it did look dangerous back there, but how could I tell for sure?" The answer to that one is that you can't. You can only study and hope to draw intelligent inferences.



On August 10 President Nixon met with 100 selected financial analysts in "secret session." According to Alden Wells (Monetary Report, Box 491, Exeter NH 03822) Mr. Nixon wanted the Dow over 1000 by election time and he wanted the public brought into the act. We will soon see whether the President can order the market to perform as he desires and for his own political purposes.

At any rate, the second factor (aside from Mr. Nixon's desires) which is worth noting on the chart of the Averages is that during each of the previous Dow Industrial ascents into the rarefied 970-990 area, the Transports had been leading the way (as was the case during 1966 and 1968). But in the current instance, we note that the Transportation Average recorded its high on April 12, 1972, at 275.85, certainly a respectably high figure (just four points under the 1968 all-time high). But then something happened.

Transports turned down on April 13, skidding to a low of 225.47 on July 12. Since then, despite the "juice" in the Industrial Average, the Transports have acted sluggishly. They reached a recent peak of 237.68 on August 12 (48 points under their high for the year) and then turned down again (see page 1 chart of the Averages).

This inferior performance on the part of Transports caught the Industrials in the 970 area, and that Average retreated in the face of the disconcerting weakness in Transports. So the question is, will the Transports turn around and give the market the technical "boost" it needs to take the Dow up to and over 1000? Will the technical situation straighten out and fulfill President Nixon's dreams? Subscribers should remember that I only study and interpret the market, I don't make it. But I will say that the current "push" towards the 1966 Dow highs is different than the 1966 and 1968 assault. This time neither the Transports nor the advance-decline ratio are behind the market. They could turn up and perform, but as of this writing they have not.

Which, of course, is one of the fascinations of indicators and averages; they simply will not take orders or suggestions from presidents, cabinet ministers, treasurers or anyone else.

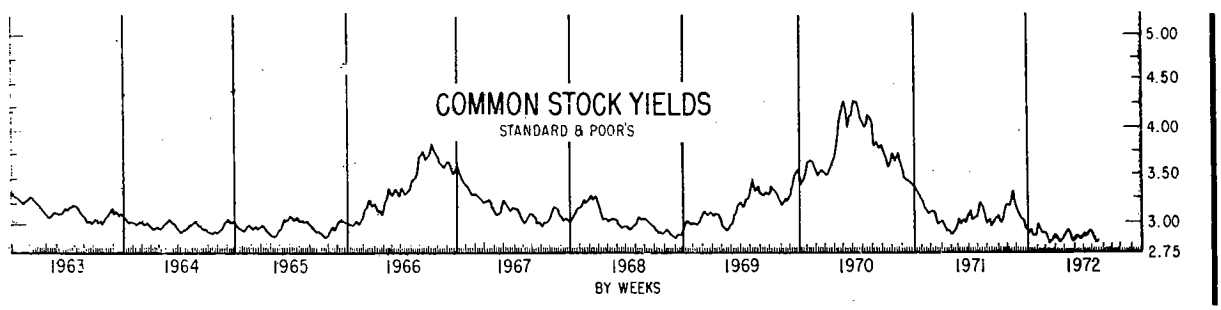
Of note here is the rallying tendencies of the Utility Average. Whether Utilities are moving up because they tend to be a defensive group, because of the sudden interest in the "energy crisis," or because they are in an attractive yield zone I cannot say. The fact is that the Utility Average has been declining almost steadily since January, 1971. The Dow Utility Average affords an average yield of around 6%. They are probably as safe an investment-grade group as can now be found. The natural gas segment of the Utility group has turned bullish on a relative strength basis, although the electric segment has not.

YIELDS & AVERAGES: Last week (see chart) the yield on the broadly-based Standard & Poor's 500 Stock Average sank to 2.78%, a record low. The only two previous instances of yields dropping to this kind of low level are shown on the chart, the first appearing in late 1965 and the second appearing at the end of 1968.

Both of these extremely low-yield areas were indicative of developing market tops. Of course we know that the 1965 yield in the 2.80's preceded the first major drop in the bear market, the decline from the 1966 Dow top of 995.15 to the late-1966 low of 744.32.

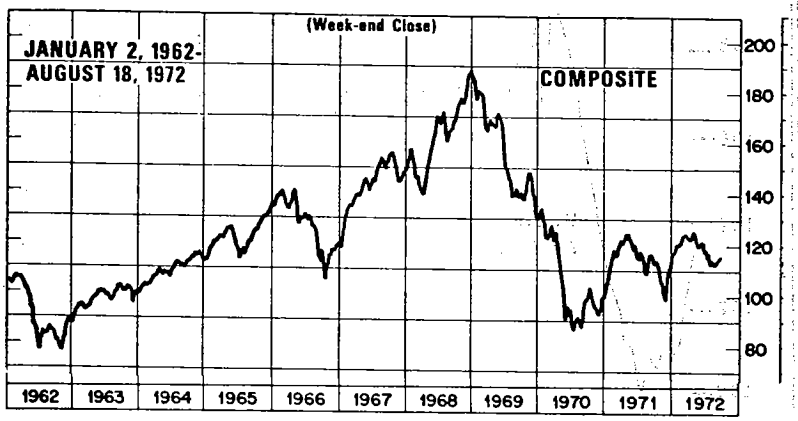
The end-of-1968 plunge in the yield on the S & P 500 to the 2.80% preceded the violent 1969-70 bear legs, moves which took the Dow from a high of 985.21 to a 1970 low of 631.16.

Now we have a new historic low on the yield in the S & P 500 Average, a low below anything ever seen before. This extraordinary low in yield is undoubtedly one of the fundamental negative forces on the recent and current poor breadth showing. The fact is, based on a fundamental yield basis, the vast majority of stocks are now far too dear. Based on historical precedent, when stocks are this expensive (based on their average yields) they are in a top area.



This is the reason why only the "weighted" averages like the S & P's Averages and the NYSE Average are in new high ground, simply because a number of very heavily weighted stocks like IBM and Eastman Kodak (with their huge capitalizations) have pushed these Averages through the roof. But on the unweighted averages such as Indicator Digest's IDA or the Value Line Average we are still nowhere near a new high. It is also the reason why the advance-decline ratio (which of course is totally unweighted and deals only in the number of stocks which are listed) is far, far from even confirming this move.

WEEKLY CHART - VALUE LINE AVERAGES



As a point of interest, I am reproducing Value Line's Composite Average (at right), and here we see the vast damage which was done to the market during the crushing 1969-70 collapse. We also see that the recovery since mid-1970 has been far less than that which is suggested by the weighted Averages. Obviously, something is "wrong" with the great majority of stocks which have been unable to recover from the shock of the 1969-70 crash.

Even on a short-term basis we see now that the majority of issues (as measured by the A-D ratio) have been unable to move out on the current rally. Many analysts claim that this upward move will continue until the public is brought in. Frankly, with 500 or more issues declining every day (regardless of what the Averages do) I do not see the public coming in at all. The public is still being hurt on what stocks they now own, much less coming in for more.

(Note: A friend just completed a study showing that 16 leading stocks account for a total value of $224 billion or 28% of the value of the entire NYSE listings! These stocks account for almost one-third of the movement in the S & P 500 Average).

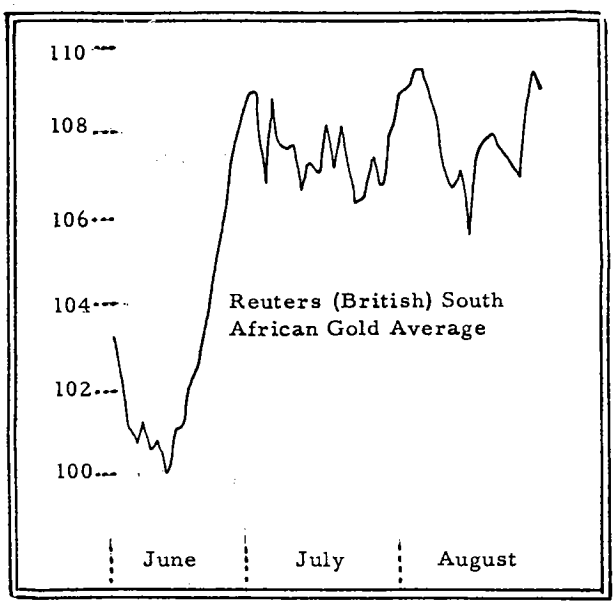
THOUGHTS, GOLD, MONEY: Ex-"Beatle" George Harrison is considered one of the greatest fund raisers of all time. His recent Madison Square Garden rock concert for Bangladesh raised (with all film, record, etc. rights) an amazing $15 million dollars for the thousands of starving, raped and beaten citizens of Bangladesh. How is this for an insane comparison? The US Government is the greatest spender of all times. Its new space shuttle program alone is going to cost upward to $3.6 billion dollars. Oh yes, the US is also going to run short of money during the coming fiscal year. It is going to have to raise more than $35 billion.

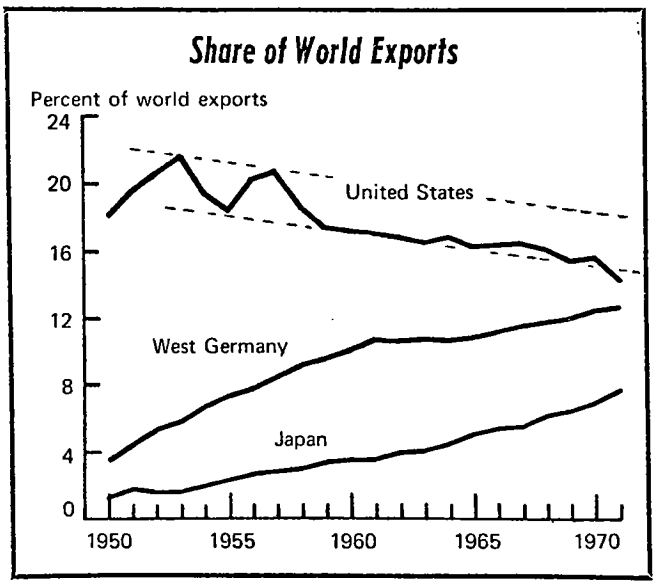
People wonder, in the face of today's "prosperity," why the stock market isn't reflecting all this good cheer and why it isn't soaring through the roof. Investors wonder why rallies in the market today are led by a handful of stocks while the "breadth" of the market stays stalled in the area of its 1971 lows. And other people who are familiar with history and the deterioration of currencies wonder if the world isn't losing its collective mind.

The winds of inflation are blowing hard these days, and, having started in the Anglo-Saxon nations of the US and Britain, they are now sweeping across the face of the globe. Almost monthly we hear of a new devaluation as nation after nation throws in the sponge on holding the value of its currency, and all the while the paper mountain gets larger and larger. As quoted in the last Letter (report from Reuters), it isn't a case of the dollar holding its own against other currencies any more, it's a case of all currencies holding their value against gold.

Nevertheless, the US has its own unique problems, one of which (see chart on page 6) is that the rest of the world is learning how to out-produce the US, at least from the standpoint of relative value. Last year, for the first time, Germany's share of manufactured exports to the world market actually exceeded those of the US! Since the early 1960's, the value of Japan's manufactured exports to the world increased six fold. From 1958 to the 1971 US exports of manufactured good slipped from 27.7% to just under 20%.

The battle of exports is slowly building up. The sand in the gears is inflation, for inflation boosts a nation's costs and lowers its export potential. Therefore, like it or not, I see a world-wide fight against inflation coming, and that fight will undoubtedly start overseas where experience with, and fear of, inflation is greatest. All this the stock market also sees, all this it will be discounting as it makes its way through the second half of 1972.

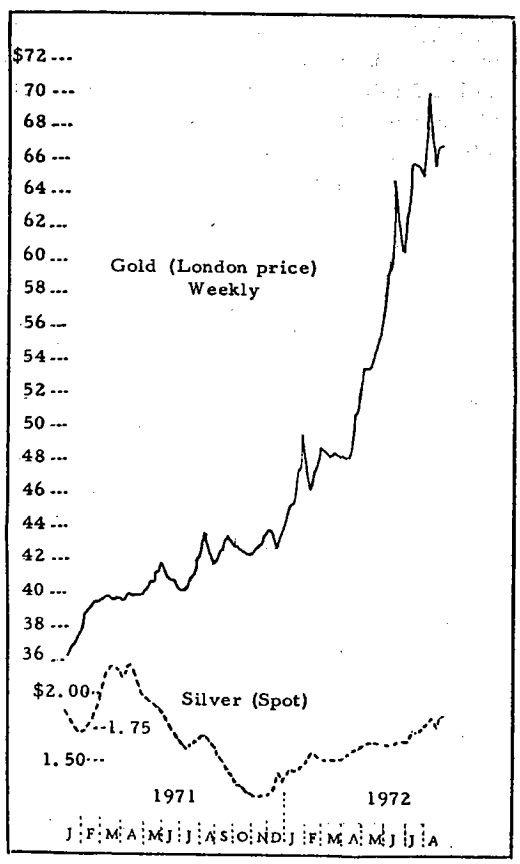




During the week ending August 25, the American Depository Receipts (ADR's) of most S. African golds sold off sharply. Whether this was brought on by an influential advisory service suggesting some profits or by rumors that the IMF would try to peg gold at $50 to $70 per ounce (or both) I do not know. What I do know is that it was basically the ADR's which went down, not the actual price of the S. African gold shares as they are actually traded in London.

I include this chart of the Reuters S. African Gold Index plotted through August 25, and as you can see the Reuters Index (reflecting actual trading price in London) indicates that most gold shares are near their highs. In fact, the Reuters Index is within a point of its high for the year! My conclusion is that there is no real market for gold shares in the US, and that the slightest rumor will scare Americans into dumping their ADR's. This would also indicate that many Americans hold gold shares merely on the hope of trading profits, not as a hedge against the deterioration of paper money.

EQUITIES: "Russell," a friend asked, "You're 'supposed' to be an educated man in the stock market business. Where does the word equities come from?" "Equities," piped I, "well, equal parts. Each share of common stock represents an equal part of the company." "You're an ignorant man, Russell," said he, and he gave me this little clip, which I include.



In the "Golden Age" of Greece, gold was not the only standard of wealth. The extent of a man's possessions indicated his affluence. Of these possessions, horses were perhaps the most important of one's chattels. A most impressive and tradable commodity, the horse was man's best friend financially. Hence the term *equity*, denoting "wealth, or ownership" is derived from *equestrian*, meaning "of horses." The *Equites* were members of a specially privileged class of citizens in ancient Greece and Rome, from which the cavalry was formed. Still today, the ownership of horses is considered evidence of wealth.